ARAB MALAYSIAN FINANCE BHD

v.

KOH KIEN HONG

HIGH COURT MALAYA, KUALA LUMPUR
ABDUL WAHAB PATAIL J
[CIVIL SUIT NO: D4-22-2027-1999]
22 MAY 2008

BANKING: *Banks and banking business - Loans secured by charge - Charge over shares - Foreclosure of shares upon default of loan - Chargee given discretion to sell shares upon such terms and in such manner as chargee may in its absolute discretion think fit - Shares sold over a period time - Whether chargee guilty of gross negligence or willful default in failing to sell shares when market price was higher*

BANKING: *Securities for advances - Charge to secure bank facilities - Charge of shares - Chargee given discretion to sell shares upon such terms and in such manner as chargee may in its absolute discretion think fit - Shares sold over a period time - Whether chargee guilty of gross negligence or willful default in failing to sell shares when market price was higher*

CONTRACT: *Damages - Mitigation - Loan agreement - Sale of charged shares by chargee bank pursuant to default of loan agreement by chargor - Chargee given discretion to sell shares upon such terms and in such manner as chargee may in its absolute discretion think fit - Shares sold over a period time - Whether chargee should have sold shares when market prices were higher - Whether chargee failed to mitigate losses - Whether general duty to mitigate losses applied*

The defendant secured a term loan facility ("the loan facility") from the plaintiff of a sum of RM4,000,000. The tenure of the loan facility was for a period of one (1) year from the date of the first draw-down. The defendant was required to provide security for the loan by pledging approximately 3,000,000 shares ("the said shares"). The loan amount of RM4,000,000 was disbursed to the defendant on 15 December 1994 and was due for full settlement on 1 January 1996. At the end of the tenure of the loan facility, the plaintiff offered to extend the tenure until 31 December 1996 and this offer was duly accepted by the defendant. During the tenure of the loan, due to the defendant's failure to make the necessary payments towards the loan facility, the plaintiff enforced its rights to force-sell the shares pledged. Disposition of some of

the shares began on 8 April 1996 to 31 December 1996. The plaintiff on 28 December 1996, offered to extend the tenure of the loan facility until 1 January 1998 but the defendant did not accept the offer. The defendant failed to service the loan. The plaintiff then disposed the remainder of the shares in tranches commencing from 2 January 1997 to 6 April 1999. Having disposed off the entire shares which were pledged, the plaintiff now claimed the shortfall the sum of RM862,746.78 as still due and owing to them. The defendant claimed that when the loan facility was not extended beyond 1996, the balance of the shares which were pledged ought to have been sold immediately in 1997. The defendant contended that, bearing in mind the price of the shares during that period, had the plaintiff sold the balance of the shares in early 1997, there was every probability that the outstanding sum claimed by the plaintiff would have been settled perhaps with a surplus due and repayable to the defendant.

Held (allowing the plaintiff's claim):

(1) Since the plaintiff was given the discretion to sell the shares upon such terms and in such manner as the plaintiff may in its absolute discretion think fit, the gross negligence or willful default cannot refer to terms or manner of disposal of the shares or any of them but to other acts of gross negligence or wilful default. If the plaintiff forgot about the shares, that may be evidence of gross negligence. Or if there was evidence the plaintiff actively sought to dispose only when prices were low, that may be evidence of willful default. But where it proceeded with the disposal of the shares, the terms and manner of disposal, which includes timing and volume, were matters within the absolute discretion of the plaintiff. (para 17)

(2) A holder of security is not held to know prices would fall and continue to fall or likewise rise. He is entitled to wait as long as he sees fit, to hope prices will rise so that he may better recover from the proceeds. (para 19)

(3) There being no evidence the plaintiff knew that prices of shares would fall and continue to fall, the plaintiff's timing of disposal of the shares and consequent incidental loss on their own was not gross negligence. There was no evidence that the plaintiff delayed with a view to cause loss so as to constitute willful default. (para 25)

(4) The general duty to mitigate losses was incapable of practical application since no party had control of the market. The argument that the defendant's loss could have been mitigated if all the shares were sold at expiry of the tenure was defeated by the contractual term that the plaintiff may dispose off all the title to and interest in the Mortgaged Securities or any of them upon such terms and generally in such manner as the plaintiff may in its absolute discretion think fit. (para 26)

Case(s) referred to:

Asia Commercial Finance (M) Bhd & Anor v. Development & Realtor Sdn Bhd [1992] 2 CLJ 1175; [1992] 2 CLJ (Rep) 109 FC ***(refd)***

Hong Leong Finance Ltd v. Datuk Mohd Salleh Yusof [1989] 1 LNS 98 HC ***(refd)***

Hwang-DBS Securities Bhd v. Harun Jasin [2004] 1 CLJ 33 HC ***(refd)***

Malayan Banking Berhad v. Lim Poh Ho & Anor [1997] 2 CLJ 516 CA ***(refd)***

Raju Jayaraman Kerpaya v. Chung Khiaw Bank Ltd [1997] 3 CLJ 216 CA ***(refd)***

Sime Securities Sdn Bhd v. Anthony Lee Sin Choy [2003] 1 CLJ 288 HC ***(refd)***

For the plaintiff - SP Tan (CY Sing with him); M/s Abd Aziz Chen & Co
For the defendant - SN Seelan (Annabela Subashini with him); M/s Athi Seelan

Reported by Amutha Suppayah

JUDGMENT

Abdul Wahab Patail J:

The Background

[1] The defendant Koh Kien Hong secured a term loan facility ("the loan facility") from the plaintiff Arab Malaysian Finance Berhad of a sum of RM4,000,000 under a letter of offer dated 12 December 1994 and a loan agreement ("the loan agreement") dated 14 December 1994. The tenure of the loan facility was for a period of one (1) year from the date of the first draw-down. The full loan amount was to be released in one lump sum. In consideration of granting the loan facility, the defendant was required to provide security by pledging his approximately 3,000,000 shares in Sateras Resources (M) Bhd ("the said shares") with a memorandum of deposit dated 14 December 1994

("the memorandum") and a Power of Attorney ("the PA") executed, stamped and registered by the defendant, and deposited with the plaintiff. The entire loan amount was to be repaid to the plaintiff in one lump sum at the end of the tenure of the loan facility or by redemption of the pledged shares, which ever is the earlier. The defendant gave the drawdown notice to the plaintiff *vide* a letter dated 15 December 1994. The loan amount of RM4,000,000 was disbursed to the defendant on 15 December 1994. The loan facility was due for full settlement on 1 January 1996.

[2] Through a letter dated 3 January 1996, the plaintiff had demanded from the defendant a total sum of RM4,219,057.83 as at the end of the tenure of the loan facility. The plaintiff also indicated its intention to enforce its rights to dispose off the shares pledged to it in the event the payment was not forthcoming. Subsequently, *vide* a letter dated 1 March 1996, the plaintiff had offered to extend the tenure of the loan facility to the defendant until 31 December 1996. This offer was duly accepted by the defendant on 7 March 1996 whereupon confirmation of acceptance was duly signified by the defendant at the foot of the plaintiffs letter.

[3] The defendant admitted that during the tenure commencing from 1 January 1995 to 31 December 1996 he was constantly reminded to regularize his account by either making necessary payments towards settling the outstanding arrears of the loan facility or alternatively to provide additional security in cases of shortfall when the market value of the shares pledged with the plaintiff fall below the prescribed ratio of 2:1. According to the defendant, non-compliance to some of these demands resulted in plaintiff taking the necessary steps to enforce its rights to force-sell the shares pledged with it with a view to either regularize the account or to reduce the outstanding amount. Disposition of the shares began on 8 April 1996 to 31 December 1996. A total of 1,131,000 shares were sold during this period and the proceeds secured by virtue of the sale were RM2,164,158.09. Although these shares were sold in tranches, they were in fact sold during the currency of the loan facility ie, when the loan facility was still on going. On 11 June 1996 the defendant irrevocably authorized the plaintiff to dispose off Sateras Resources (M) Berhad shares pledged with them under the loan facility at the prevailing market

price and to utilize the proceeds towards payment in satisfaction of two different accounts. The instructions were to remain irrevocable until all shares had been disposed off.

[4] On 20 December 1996 the defendant requested the tenure of the loan facility to be extended for another year. In response thereto the plaintiff, *vide* a letter dated 28 December 1996, offered to extend the tenure of the loan facility until 1 January 1998. The defendant did not signify his acceptance to the said offer. In the absence of any acceptance, the said offer had lapsed in accordance with the terms of the offer. Since the beginning of 1997 the defendant had not been servicing the said facility.

The Defence

[5] The defendant now argues that in view of his non-acceptance of the extension of the tenure of the loan facility he had expected the plaintiff to exercise its rights under the loan agreement and the memorandum of deposit by forcibly selling off and/or disposing all the shares pledged with the plaintiff as authorized by the defendant on 11 June 1996 to recover the outstanding amount due to them. The defendant maintains that instead of selling and/or disposing off the entire shares pledged with them upon the expiry or the loan facility, the plaintiff chose to dispose the shares in tranches commencing from 2 January 1997 to 6 April 1999, and having disposed off the entire shares which were pledged, the plaintiff now claims as the shortfall the sum of RM862,746.78 as still due and owing to them.

[6] It was submitted for the defendant that when the loan facility was not extended beyond 1996, the balance of the shares which were pledged ought to have been sold immediately in 1997, bearing in mind the price of shares during that period was between RM1.70 and RM2. The defendant's contention is that had the plaintiff sold the balance of the shares in early 1997, there was every probability that the outstanding sum as claimed by the Plaintiff would have been settled perhaps with a surplus due and repayable to the defendant.

[7] It was also submitted for the defendant that plaintiff had unreasonably withheld the balance of the shares from being sold immediately after the expiry of the tenure of the loan facility and instead had decided to sell them in 1999 when the prices of the shares were as low as RM0.30, and by reason thereof, the plaintiff had acted negligently in exercising its rights provided to

them under the loan agreement as well as under the memorandum. The defendant also contended that the plaintiff had through its willful default failed to mitigate their losses and should not therefore be allowed to make a claim of this nature.

[8] The issues put before the court were therefore:

(i) Whether the loan facility expired in 1996?

(ii) Whether the balance of the shares pledged with the plaintiff as at 1 January 1997 ought to have been sold immediately after the expiry of the tenure of the loan facility?

(iii) Whether the plaintiffs failure to sell the balance of the shares pledged as at 1 January 1997 constitute "gross negligence or "willful default"?

(iv) Whether the plaintiff could have mitigated their losses by selling the shares upon the expiry of the tenure of the loan facility?

Whether The Loan Facility Expired In 1996

[9] The loan facility granted to the defendant was for a term of one year from January 1995 to December 1995. That tenure was extended for a further term of one year at the request of the defendant. The plaintiff's offer for extension of the tenure of the loan facility was made in writing. This was done on two occasions. The first offer was made *vide* a letter dated 1 March 1996 ("the first offer") upon which the defendant had signified his acceptance on 7 March 1996. This was also confirmed by the plaintiff's witness, one Seow Swee Eng (PW1) in his witness statement.

[10] The second extension was offered to the defendant by the plaintiff through their letter dated 28 December 1996 ("the second offer"). This was to extend the tenure of the loan facility for a further period of one year from January 1997 to the end of December 1997. The defendant did not signify his acceptance on this second offer. This clearly shows that the defendant did not intend to continue with the loan facility for another year. There is no other evidence to suggest that the loan facility had been extended beyond the year 1996. In the absence of any acceptance or any other evidence of an extension, the court can only conclude that the tenure of the loan facility expired at the end of December 1996.

Whether The Balance Of The Shares Pledged With The Plaintiff As At 1 January 1997 Ought To Have Been Sold Immediately After The Expiry Of The Tenure Of The Loan Facility?

Whether The Plaintiff's Failure To Sell The Balance Of The Shares Pledged As At 1 January 1997 Constitute "Gross Negligence Or "Willful Default"?

Whether The Plaintiff Could Have Mitigated Their Losses By Selling The Shares Upon The Expiry Of The Tenure Of The Loan Facility?

[11] The three issues are inter-related and may best be dealt with together.

[12] The defendant submitted that since the tenure of the loan facility expired in December 1996, the shares pledged with the plaintiff as at 1 January 1997 ought to have been sold immediately thereafter:

(i) the plaintiff ought to have recovered whatever amounts due to them under the loan facility had the shares pledged with them were sold on 2 January 1997 immediately after the expiry of the tenure of the loan.

(ii) The plaintiff in exercising their rights to sell the shares under the loan agreement as well as the memorandum had been grossly negligent and at all material times acted in willful default disregarding the interest of the defendant who had every probability to receive surplus payment from the proceeds of sale had the shares been sold on 2 January 1997.

(iii) The plaintiff had failed to mitigate their losses by taking the necessary to extinguish or minimize their losses.

[13] The date of expiry of the original tenure of the term loan was on 31 December 1995. The defendant sought and obtained the plaintiff's agreement for an extension of tenure to 31 December 1996. The plaintiff's agreement was given through the plaintiff's letter dated 1 March 1996. Even so, the defendant defaulted in paying the arrears of instalment, as evident from the plaintiff's letters of demand at pp. 82 and 84 of the bundle of documents. The defendant gave authority on 11 June 1996 as follows:

A Sale Of Sateras Resources (M) Berhad Shares Which Constitute Security For Term Loan Facility Of RM4,000,000.00.

I hereby irrevocably authorise you to dispose of Sateras Resources (M) Berhad shares currently pledged to you under the above facility at the prevailing market price.

B

The proceeds whereof shall be applied at your discretion towards the reduction of the following liabilities as below:

a) Term loan Account No 01/CLO/TL/1854 in favour of Koh Kien Hong.

C

b) Industrial Hire Purchase facility of RM5,000,000.00 in favour of Kien Sinar Sdn Bhd.

This instruction shall be irrevocable until all the shares have been disposed off.

D

[14] On 8 April 1996, the plaintiff started to dispose off the shares. Even so, by a letter dated 20 December 1996, the defendant had again requested from the plaintiff an extension of the tenure of the term loan for another year. The plaintiff, by a E letter dated 28 December 1996 produced at p. 116 of the bundle of documents, agreed to extend the tenure of the term loan to 1 January 1998. The defendant then did not respond whether to accept or not.

F **[15]** The letter of offer dated 12 December 1994 at item 13(ii) stated that the loan shall be repaid in one lump sum at the end of the tenure or by redemption of the pledged shares, whichever is the earlier was cited in support. It was submitted that since the tenure of the loan facility came to an end in December 1996, the G liability of the defendant to settle the entire loan amount and/or any part thereof which was still due and outstanding arose immediately thereafter. It was argued that any default and/or non-compliance to any notice of demand for the repayment of the entire loan amount and/or any part thereof which was still due H and payable enabled the plaintiff to exercise their right to seek for remedies in accordance with the terms and conditions of the loan agreement and the memorandum.

[16] On the ground of wilful default or gross negligence, the I defendant relied on cl. 5 of the memorandum of deposit which provides in respect of the power of sale of the shares deposited that:

> If AMFB declares the Facility to be immediately due and payable under the Letter of Offer and/or the Loan Agreement or if the Borrower should fail on demand to pay any sum due to AMFB under this Memorandum or the Letter of Offer or the Loan Agreement or otherwise fail to comply with any of the Borrower's obligations under this Memorandum or the Letter of Offer or the Loan Agreement, the monies hereby secured shall thereupon become due and AMFB as the absolute unencumbered owner thereof may then or at anytime thereafter and without prior notice to the Borrower sell or otherwise dispose off all the title to and interest in the Mortgaged Securities or any of them upon such terms and generally in such manner as AMFB may in its absolute discretion think fit and so that AMFB shall not be liable for any loss or damage occasioned by such sale or disposal unless caused by AMFB's own gross negligence or willful default; and also that AMFB shall be entitled to apply the proceeds of sale or disposal in or towards the discharge of the Borrower's liabilities under this Memorandum or the Letter of Offer or the Loan Agreement in such manner as AMFB may in its absolute discretion think fit, with any surplus being paid to the Borrower or any other person who may be entitled to it.

[17] Although cl. 5 provides that "AMFB shall not be liable for any loss or damage occasioned by such sale or disposal unless caused by AMFB's own gross negligence or willful default", these words must not be read in isolation but within the context of cl. 5 itself, which is a power of sale authorising "AMFB as the absolute unencumbered owner thereof may then or at anytime thereafter and without prior notice to the borrower sell or otherwise dispose off all the title to and interest in the Mortgaged Securities or any of them upon such terms and generally in such manner as AMFB may in its absolute discretion think fit". Since AMFB was given the discretion to sell or otherwise dispose of the shares or any of them upon such terms and in such manner as AMFB may in its absolute discretion think fit, the gross negligence or willful default cannot refer to terms or manner of disposal of the shares or any of them but to other acts of gross negligence or wilful default. If the plaintiff forgot about the shares, that may be evidence of gross negligence. Or if there is evidence the plaintiff actively sought to dispose only when prices are low, that may be evidence of willful default. But where it proceeded with the disposal of the shares, then the terms and manner of disposal, which obviously includes timing and volume, are matters within the absolute discretion of the plaintiff.

[18] It is within the nature of the share market that prices may rise and fall, and that only the forces of supply and demand of willing buyers and willing sellers and no other, determine the prices. No matter how many and at what price the shares are offered for sale at a time, the actual sale price and volume depends upon the buyer. No doubt a larger volume could be sold very quickly if the sale price offered is reduced substantially, but that would not have been in the defendant's interest.

[19] A holder of security is not held to know prices would fall and continue to fall or likewise rise. He is entitled to wait as long as he sees fit, to hope prices will rise so that he could have a better recovery from the proceeds. In *Sime Securities SB v. Anthony Lee Sin Choy* [2003] 1 CLJ 288 the court found the plaintiff failed to carry out direction to sell. The case of *Hwang-DBS Securities Bhd v. Harun Jasin* [2004] 1 CLJ 330 was relied upon as suggesting it is incumbent upon the plaintiff to have sold the prices quickly since at the time the prices were at its highest. However that overlooks this part of the judgment:

> It would of course be somewhat unrealistic to impose an overly onerous duty on the stockbroker by insisting that he sells them off at the highest price to mitigate his client's loss. Time is always of the essence in the volatile environment of the stock exchange and a stockbroker is perfectly entitled to look after his own interest in as much as he may have to contemplate on his client's interest. I would therefore consider the stockbroker's duty discharged if he acts *bona fide* with reasonable promptitude to dispose of his client's shares to recover his loss at the price then prevailing.

[20] This instant case involves shares pledged as security for a loan. It was held by the Court of Appeal that the plaintiff is at liberty to dispose off its security at any time: *Raju Jayaraman Kerpaya v. Chung Khiaw Bank Ltd* [1997] 3 CLJ 216 at 224 CA. All its remedies could be exercised at any time or times, and simultaneously, contemporaneously, successively or not at all. In *Hong Leong Finance Ltd v. Datuk Mohd Salleh bin Yusof* [1989] 1 LNS 98 the High Court in Singapore held:

> The plaintiffs, as a mortgagee, after the power of sale had arisen, were entitled to sell the shares at such time as they think fit and in selling the shares they were under a duty to act in good faith and to obtain the true market value therefor at the date or dates when they were sold. They were under no obligation to wait for

the market to turn and improve. In the leading case on this subject *Cuckmere Brick Co Ltd & Anor v. Mutual Finance Ltd* [1971] Ch 949 at p. 965. Salmond J (as he then was) said: It is well settled that a mortgagee is not a trustee of the power of sale for the mortgagor. Once the power has accrued, the mortgagee is entitled to exercise it for his own purposes whenever he chooses to do so. It matters not that the moment may be unpropitious and that by waiting a higher price could be obtained. He has the right to realise his security by turning it into money when he likes. Nor, in my view, is there anything to prevent a mortgagee from accepting the best bid he can get at an auction, even though the auction is badly attended and the bidding exceptionally low. Providing none of those adverse factors is due to any fault of the mortgagee, he can do as he likes.

[21] In *Asia Commercial Finance (M) Bhd. & Anor. v. Development & Realtor Sdn. Bhd.* [1992] 2 CLJ 1175; [1992] 2 CLJ (Rep) 109; Edgar Joseph Jr. FCJ had this to say:

The issue of the appropriate standard of care owed by the chargee to the chargor is not free from difficulty.

One line of authority is to the effect that a mortgagee's only duty is to act *bona fide* in the conduct of the sale (see *Kennedy v. De Trafford* [1987] AC 180; *Warner v. Jacob* [1881] 20 Ch D 220). In the latter case, Kay J said at p. 224:

> ... a mortgagee is strictly speaking not a trustee of the power of sale. It is a power given to him for his own benefit, to enable him to better to realise his debt.
>
> If he exercises it *bona fide* for that purpose, without corruption or collusion with the purchaser, the Court will not interfere even though the sale be very disadvantageous, unless indeed the price is so low as in itself to be evidence of fraud.
>
> In the Australian case of *Pendlebury v. Colonial Mutual Life Assurance Society Ltd* [1912] 13 CLR 676, 699 Isaacs J stated that "so long as (the mortgagee) observed specified formalities and acts in good faith his conduct cannot be challenged.

[22] In *Malayan Banking Berhad v. Lim Poh Ho & Anor* [1997] 2 CLJ 516 the Court of Appeal followed *Asia Commercial Finance (M) Bhd. & Anor. v. Development & Realtor Sdn. Bhd. (supra)* and added:

To reinforce what was said by YA Edgar Joseph Jr. FCJ at p. 517 of his decision, on the need to prove that the under value was so gross as to indicate fraud or want of proper standards of care, I would with respect adopt the remarks by Peter Butt at p. 181 of his article. It reads:

> On the other hand, it is also beyond doubt that a mortgagee may not exercise the power of sale in a fraudulent manner. It has been said that the price realised may be so low as to be itself evidence of fraud on the part of the mortgagee, but it is clear from the decided cases that the quantum realised, although relevant, will not normally be conclusive. It is only an exceptionally low price which, *per se*, conclusively demonstrates fraud (as, for example, where a property worth RM1,600 was sold for 25 cents, one worth RM5,500 was sold for RM50, and one worth between RM13,000 and RM19,000 was sold for RM1,000). Generally, inadequacy of price will need to be coupled with other factors, such as inadequate marketing or knowledge, that another buyer may be prepared to pay a better price, before the sale will be set aside. In any case, the value of real estate is largely a matter of opinion, and it is to be expected that the mortgagor may have an inflated idea of its worth, while the buyer naturally takes a conservative view of the value of what he is buying.

[23] The learned judge *Hwang-DBS Securities Bhd v. Harun Jasin (supra)* in the High Court did not have the benefit of the above cases. Nor did the learned judge in *Sime Securities Sdn Bhd v. Anthony Lee Sin Choy* [2003] 1 CLJ 288 HC.

[24] The defendant relies solely upon the fact that the plaintiff did not proceed to dispose off the shares as soon as the term of the facility ended. But looking forward from the standpoint of the end of 1996, there was a financial crisis in Korea and Thailand. It was a time of uncertainty on the economic outlook. No party can say with confidence whether the prices of shares in Malaysia will fall or will rise. Those who are optimistic believed the financial crises overseas would not affect Malaysia and the share prices could even rise. Given the uncertainty, it was the wise thing to do to dispose of assets, particularly shares, in tranches over a period of time. It was in the middle and later part of 1997 that saw the dramatic falls in the share market. Only in hindsight, knowing that share prices fell and continued to fall, that one could make the conclusion it would have been wiser to sell all the shares as early as possible.

[25] Given that no party can control the market or predict the future as to share prices, and there being no evidence the plaintiff knew that prices of shares would fall and continue to fall, the plaintiff's timing of disposal of the shares and consequent incidental loss on their own is not gross negligence. There is no evidence that the plaintiff delayed with a view to cause loss so as to constitute wilful default.

[26] The general duty to mitigate losses is incapable of practical application since no party has control of the market. The argument that the defendant's loss could have been mitigated if all the shares were sold at expiry of the tenure is defeated by the contractual term that the plaintiff may dispose off all the title to and interest in the Mortgaged Securities or any of them upon such terms and generally in such manner as AMFB may in its absolute discretion think fit.

[27] The answer to the second issue must be that the plaintiff had no obligation to sell the shares held as security immediately. The court finds there was neither gross negligence nor wilful misconduct proved. In the event the question of mitigation of loss does not arise.

[28] Judgment was entered for plaintiff in sum of RM862,746.78 as at 31 May 1999 plus interest at 1% plus 2.5% above plaintiff's base lending rate with daily rests from 1 June 1999 to date of judgment and at the statutory rate from the date of judgment to full settlement.